(5)

No. 95-325

IN THE
Supreme Court of the United States
OCTOBER TERM, 1995

UNITED STATES OF AMERICA,
Petitioner,

v.

REORGANIZED CF&I FABRICATORS OF UTAH, INC.,
et al.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF OF THE PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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INTEREST OF THE AMICUS CURIAE

The Pension Benefit Guaranty Corporation ("PBGC") is a wholly-owned United States government corporation, 29 U.S.C. § 1302, modeled after the Federal Deposit Insurance Corporation, 120 Cong. Rec. 29950 (1974) (statement of Sen. Bentsen). PBGC guarantees the payment of nonforfeitable benefits in defined benefit pension plans

sponsored by private businesses. *See generally PBGC v. LTV Corp.*, 496 U.S. 633 (1990); *Nachman Corp. v. PBGC*, 446 U.S. 359 (1980).[1]

This case involves the treatment in bankruptcy of excise taxes that Congress imposed to encourage companies to fund the pension plans insured by PBGC. Respondents have asserted and the courts below assumed that a decision in favor of the Internal Revenue Service would be harmful to PBGC because it would diminish the funds available for distribution to PBGC in this case. That is not PBGC's view. PBGC believes that a decision in favor of the IRS would greatly benefit PBGC's insurance program because it would establish unequivocally that employers must fund their pension plans regardless of bankruptcy. It would thus have an extremely beneficial effect on pension funding in other plans and therefore, in the long run, on PBGC's financial health. For the same reason, it would benefit millions of participants in other pension plans whose pensions PBGC protects.

[1] PBGC, "an agency of the United States authorized by law to appear on its own behalf," files this brief *amicus curiae* pursuant to Rule 37.5 of this Court's rules. *See* 29 U.S.C. § 1302(b)(1) (PBGC has the power "to sue and be sued, complain and defend, in its corporate name and through its own counsel, in any court, State or Federal"). PBGC has appeared in this Court through its own counsel both as a party, *see, e.g.*, *LTV*, 496 U.S. 633; *Nachman*, 446 U.S. 359, and as an *amicus curiae*, *see, e.g.*, *Concrete Pipe & Prods. of California, Inc. v. Construction Laborers Pension Trust*, 113 S. Ct. 2264, 2278 (1993); *Commissioner v. Keystone Consol. Indus.*, 113 S. Ct. 2006, 2013 n.3 (1993); *Mead Corp. v. Tilley*, 490 U.S. 714, 722, 726 (1989).

Besides its concern with pension funding, PBGC has an interest in the principles of law applied to determine the priority of tax claims in bankruptcy. The event that usually necessitates a PBGC takeover of a pension plan is the bankruptcy of the company sponsoring the plan. PBGC files claims as federal guarantor for the overall funding shortfall and, in its separate capacity as statutory trustee, for employer contributions owed to the plan. *See* 29 U.S.C. § 1362. PBGC asserts that portions of its claims are entitled to first priority as post-petition taxes or seventh priority as pre-petition excise taxes. Thus, the proper construction of the provisions of the Bankruptcy Code governing tax priority is of great concern to PBGC.

Respondents' assertion that a decision in favor of the IRS would be harmful to PBGC is premised in part on their assumption that PBGC's bankruptcy claims are general unsecured claims not entitled to priority. Respondents' Brief in Opposition to the Petition for a Writ of Certiorari at 3, 5. Although the bankruptcy court and the district court in this case have denied priority to most of PBGC's claims, *see PBGC v. Reorganized CF&I Fabricators, Inc. (In re CF&I Fabricators, Inc.)*, 179 B.R. 704 (D. Utah 1994), those decisions are not final; PBGC expects to appeal once there is a final order. An accurate description of the status of PBGC's claims may provide the Court a better understanding of the instant controversy.

Finally, as a major creditor in many bankruptcies, PBGC is concerned about the unfettered discretion that the court of appeals' decision would bestow upon the bankruptcy courts to subordinate the claims of innocent creditors based

on "equitable" considerations. Such wide-ranging discretion, never contemplated by Congress, could be used to deprive unpopular claimants of their statutory share of a bankrupt's assets.

STATEMENT OF THE CASE

PBGC relies principally on the Statement in the Brief for the United States.[2] Some additional background is provided below.

A. ERISA's Minimum Funding Requirements

The pension plans at issue in this case are defined benefit pension plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), *codified in* 29 U.S.C. §§ 1001-1461 (1994) *and various provisions of* Title 26 U.S.C.[3] One of Congress's central purposes in enacting ERISA was to ensure "that if a worker has been promised a defined pension benefit upon retirement -- and if he has fulfilled whatever conditions are required to obtain a vested benefit -- he actually will receive it." *Nachman*, 446 U.S. at 375. As this Court explained in *Nachman*, Congress adopted several strategies to achieve that goal. One was to provide for "a minimum funding schedule and

[2] PBGC did not participate in this dispute in the courts below.

[3] A "defined benefit" pension plan, sometimes referred to as a "traditional" pension plan, is one that promises employees a fixed retirement benefit based on such factors as final salary and years of service with the employer. *See* 29 U.S.C. § 1002(34) and (35); *Keystone Consol. Indus.*, 113 S. Ct. at 2009.

prescribed standards of conduct for plan administrators to make as certain as possible that pension fund assets would be adequate." *Id.* Another was to create PBGC to guarantee benefits in the event that "a plan nonetheless terminates without sufficient assets to pay all vested benefits." *Id.*

The minimum funding standards are set forth in section 412 of the Internal Revenue Code, 26 U.S.C. § 412.[4] Each plan must establish a "funding standard account" to which various charges and credits are made each year. 26 U.S.C. § 412(b). If sufficient contributions are not made in a given year to bring the funding standard account to zero or higher, the plan has an "accumulated funding deficiency" for that year and does not satisfy the minimum funding standard. 26 U.S.C. § 412(a).

Congress put teeth into ERISA's minimum funding requirements by enacting section 4971 of the Internal Revenue Code, 26 U.S.C. § 4971. That section imposes a tax of ten percent on any accumulated funding deficiency,[5] with an additional tax if the deficiency is not corrected.

[4] Many of the provisions of ERISA, including the minimum funding rules, are both codified in Title 29 of the United States Code and incorporated into the Internal Revenue Code. *Compare, e.g.*, 29 U.S.C. § 1082 *with* 26 U.S.C. § 412.

[5] The tax was originally five percent but was increased to ten percent in 1987. Pension Protection Act, Pub. L. No. 100-203, § 9304, 101 Stat. 1330-333, 1330-348 (1987). Because the ten percent rate applies to this case, we refer throughout this brief to the "ten percent" tax.

B. The PBGC Insurance Program

In Title IV of ERISA, Congress established a mandatory termination insurance program administered by PBGC. 29 U.S.C. §§ 1301-1461. In the event that, notwithstanding the minimum funding requirements, a pension plan terminates without enough assets to pay promised benefits, PBGC's insurance program provides a safety net. *See Nachman*, 446 U.S. at 375. When an underfunded plan terminates, PBGC takes over the assets of the plan and pays the nonforfeitable benefits, up to statutory limits. *See* 29 U.S.C. §§ 1322, 1342, 1361.

PBGC pays guaranteed benefits primarily from insurance premiums paid to PBGC by employers that sponsor covered pension plans, 29 U.S.C. §§ 1306-07, but also from amounts it collects from the employers whose pension plans have terminated, 29 U.S.C. § 1362. When an underfunded plan terminates, the employer becomes liable to PBGC for the "total amount of the unfunded benefit liabilities" of the plan. 29 U.S.C. § 1362(a), (b).[6]

This liability is intended to reimburse PBGC for at least a portion of the benefits it pays under a terminated plan. *See*

[6] The unfunded benefit liabilities represent the total shortfall in a plan's assets to pay promised benefits. *See* 29 U.S.C. § 1301(a)(18). A plan may have a shortfall even if all minimum funding contributions have been made because the funding rules allow the benefit liabilities to be funded over a period of years. *See* 26 U.S.C. § 412(b)(2)(B).

LTV, 496 U.S. at 638.[7] If the employer is in bankruptcy, PBGC asserts a tax priority claim for all or part of this liability pursuant to 29 U.S.C. § 1362. *See also* 29 U.S.C. § 1368.[8]

C. Facts and Proceedings

CF&I Steel Corporation ("CF&I") was the sponsor of two defined benefit pension plans covered by PBGC. The larger of the two plans was underfunded by more than $200 million by 1990.

For the year ended December 31, 1989, CF&I owed contributions of $12.4 million to the pension plans, almost all of which was owed to the larger plan.[9] The "immediate

[7] PBGC pays benefits up to the statutorily guaranteed level regardless of whether it recovers anything from the employer. *See* 29 U.S.C. §§ 1322, 1361.

[8] As statutory trustee of a terminated pension plan, PBGC is also empowered to collect unpaid contributions owed to the plan. 29 U.S.C. §§ 1342(d)(1)(B)(ii), 1362(c). Where a bankrupt company has missed contributions exceeding $1 million, PBGC asserts tax priority for this claim based on 26 U.S.C. § 412(n)(1), (n)(4)(C) (imposing a lien for the missed contributions and providing that "[a]ny amount with respect to which a lien is imposed" is "treated as taxes due and owing the United States").

[9] The smaller plan was eventually terminated in a "standard termination" under 29 U.S.C. § 1341(b), which meant that plan assets were sufficient to provide all promised benefits. Although the excise taxes here applied to both plans, for convenience we refer hereafter only to the "plan."

cause" of the Chapter 11 filings was the companies' inability to fund the pension plan.[10]

During the reorganization proceeding, CF&I neither made any contributions to the pension plan nor took any steps to terminate it. Because the plan was paying substantial benefits but receiving no contributions, its assets were being depleted. Faced with mounting losses, PBGC initiated an involuntary termination of the plan under 29 U.S.C. § 1342(c). The plan was terminated on March 19, 1992, and PBGC became its statutory trustee.

PBGC asserted a claim against CF&I for approximately $223 million in unfunded benefit liabilities, making PBGC one of the largest creditors in the bankruptcy. PBGC asserted that a portion of this claim was entitled to first priority as an administrative tax under sections 503(b)(1)(B) and 507(a)(1) of the Bankruptcy Code, 11 U.S.C. §§ 503(b)(1)(B), 507(a)(1). In the alternative, PBGC contended that this portion should be accorded seventh priority as an excise tax under 11 U.S.C. § 507(a)(7).

The bankruptcy court denied priority to the unfunded benefit liabilities claim. The district court affirmed, but remanded to the bankruptcy court to resolve a dispute about the amount of the claim. *Reorganized CF&I Fabricators,*

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[10] Disclosure Statement for Debtors' and Railroad Trustee's First Amended and Restated Plan of Reorganization Dated December 1, 1992, Exhibit 6 at 1-2, *In re CF&I Fabricators of Utah, Inc.*, No. 90B-6721 (Bankr. D. Utah).

179 B.R. 704. PBGC expects to appeal that ruling once a final order is issued by the district court.[11]

The Internal Revenue Service also filed proofs of claim against CF&I. These included claims for the ten percent tax under section 4971(a) of the Internal Revenue Code on the $12.4 million of minimum funding contributions CF&I failed to make for 1989. The facts and proceedings relating to those claims are described in the Brief for the United States.

SUMMARY OF THE ARGUMENT

This case involves the construction of two federal statutes. In 1974, as part of ERISA, Congress imposed a tax on an employer's failure to make required contributions to its pension plan. 26 U.S.C. § 4971(a). In 1978, in revising the federal bankruptcy law, Congress provided that "excise tax[es]" should be accorded priority in the hierarchy of creditor claims. 11 U.S.C. § 507(a)(6)(E) (1982). The first question before the Court is whether the tax on missed pension contributions is an excise tax entitled to this bankruptcy priority.

This question must be answered in the affirmative. Congress labeled this exaction a "tax," and there are compelling reasons to conclude that it must be an excise tax.

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[11] PBGC also asserted claims on behalf of the pension plan for $71 million in unpaid minimum funding contributions. The bankruptcy court and the district court denied priority status to all but a small portion of these claims as well. PBGC expects to appeal these rulings along with the denial of priority to its claim for unfunded benefit liabilities.

"Excise tax" has always been construed as a broad, residual category that includes any kind of tax that is not a direct tax on persons or property. The history of the 1978 Bankruptcy Code indicates that Congress intended to use it in this broad manner. Moreover, the legislative history of ERISA makes clear that Congress understood this exaction on missed pension contributions to be an excise tax.

The court of appeals erred in disregarding these plain manifestations of congressional intent. Instead, the court applied a four-part test formulated in *County Sanitation District No. 2 of Los Angeles County v. Lorber Industries of California, Inc. (In re Lorber Industries of California, Inc.)*, 675 F.2d 1062, 1066 (9th Cir. 1982). That test, and its antecedents in this Court's opinions, are appropriately applied to determine if a state exaction is a tax for bankruptcy purposes or if a federal exaction is such a tax where congressional intent is not explicit. It has no application in a case like this where the congressional intent is clear that the exaction is a tax.

The court of appeals also erred in subordinating the IRS tax claim under authority of 11 U.S.C. § 510(c)(1). That provision was intended to allow "equitable subordination" of a claim only where the claimant has engaged in some misconduct, which concededly is not the case here. The court of appeals' ruling would permit bankruptcy judges to disregard the detailed statutory scheme for allocation of a debtor's assets and instead allocate assets based on their own opinions about what is "equitable."

In their rulings, the lower courts relied in part on a misperception of the interests of PBGC. The courts thought that denying priority to the IRS claim and subordinating it would benefit PBGC inasmuch as PBGC is one of the largest creditors in the CF&I bankruptcy. This is too narrow a view. According priority to the IRS claim will strengthen PBGC's insurance program by helping to ensure that companies fund their pension plans in compliance with ERISA.

ARGUMENT

I. THE SECTION 4971(a) EXACTION IS A TAX ENTITLED TO PRIORITY AS AN EXCISE.

A. The Bankruptcy Code Accords Priority to All Taxes, Subject Only to Specified Time Limitations.

Taxes have long been granted priority treatment in bankruptcy. Under Section 64 of the former Bankruptcy Act, all post-petition taxes incurred by the estate were treated as "costs and expenses of administration" entitled to the highest priority. 11 U.S.C. § 104(a) (1964). All pre-petition taxes "legally due and owing" were accorded fourth priority, and the courts developed various rules to determine precisely when various types of taxes became "legally due and owing." 11 U.S.C. § 104(a)(4); *see generally* William T. Plumb, Jr., *The Tax Recommendations of the Commission on the Bankruptcy Laws -- Priority and Discharge of Tax Claims*, 59 Cornell L. Rev. 991, 1008-11 (1974). In 1966, Congress amended section 64 to limit priority treatment to

taxes that became "legally due and owing" within the three years before the bankruptcy petition.[12] Thus, under the law as it stood before 1978, all *kinds* of taxes were entitled to priority, but a particular tax claim would not receive priority if it were more than three years "old."

In the Bankruptcy Code of 1978, Congress retained the concept that all taxes would be given priority but modified and made more specific the "staleness" rules governing which taxes were too old to receive priority. Congress thus retained first priority for all post-petition taxes incurred by the bankruptcy estate. 11 U.S.C. §§ 503(b)(1)(B), 507(a)(1). For pre-petition taxes, Congress continued to accord a lower priority[13] but adopted a different approach for determining staleness. Rather than apply a three-year limit to all pre-petition taxes subject to judge-made rules regarding when the tax became "legally due and owing," Congress listed the various kinds of taxes and applied a different time limitation to each. *See* 11 U.S.C. § 507(a)(7). Among the taxes listed were income taxes, property taxes,

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[12] Pub. L. No. 89-496, 80 Stat. 271 (1966). Fourth priority was limited to those taxes "which are not released by a discharge in bankruptcy," 11 U.S.C. § 104(a)(4) (1970), and taxes exempt from discharge included those "which became legally due and owing within three years preceding bankruptcy," 11 U.S.C. § 35 (1970).

[13] Pre-petition taxes were given sixth priority in the 1978 enactment. 11 U.S.C. § 507(a)(6) (1982). Section 507(a) has been amended twice since then to include additional categories of priority claims payable before pre-petition taxes. Pre-petition taxes thus currently receive eighth priority. 11 U.S.C. § 507(a)(8). Because the priority for pre-petition taxes was seventh at all times relevant to this case, we refer to it herein as "seventh" priority and cite to it as 11 U.S.C. § 507(a)(7).

taxes required to be collected or withheld ("trust-fund" taxes), employment taxes on wages or salary, customs duties on imported goods, and "excise tax[es]." *Id.*

The new time limitations on each of these kinds of taxes both specified the number of years in the "look-back" period and the manner in which the period would be measured. *See id.*; *Green v. Beaman (In re Beaman)*, 9 B.R. 539, 541 (Bankr. D. Ore. 1980) ("Congress sought to enumerate types of taxes for the purpose of setting a time under which each tax would become stale and dischargeable").[14] Thus, for example, property taxes receive priority only if they were last payable without penalty during the year immediately before the bankruptcy filing. 11 U.S.C. § 507(a)(7)(B). Income taxes, on the other hand, are entitled to priority if they were last due during the three years before the bankruptcy. 11 U.S.C. § 507(a)(7)(A). Excise taxes likewise are subject to a three-year staleness rule.[15]

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[14] *See also Report of Commission on the Bankruptcy Laws of the United States ("Bankruptcy Commission Report")*, H.R. Doc. No. 137, Part I, 93d Cong., 1st Sess. 215-16 (1973) (discussing origins of statutory language).

[15] Claims of governmental units are entitled to seventh priority to the extent such claims are for --

> an excise tax on --
>
> > (i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

Courts analyzing these changes to the structure of the bankruptcy laws have concluded that Congress did not intend to exclude any kinds of taxes from priority. The question, as one court put it, is --

> whether a change was wrought in the law, wittingly or unwittingly, by the Congress when it undertook to specify kinds of taxes entitled to priority, instead of the simple all-embracing statement about taxes which was employed in the Bankruptcy Act.

State of Ohio, Bureau of Workers' Compensation v. TRI-Mfg. & Sales Co. (In re TRI-Mfg. & Sales Co.), 82 B.R. 58, 60 (Bankr. S.D. Ohio 1988). The court answered the question in the negative. *Id.* The listing of taxes in section 507(a)(7) "was intended to be comprehensive and include all federal and state taxes." *Beaman*, 9 B.R. at 541; *see Bankruptcy Commission Report* at 215-16.

Thus, in determining whether an exaction is entitled to priority under section 507(a)(7), the first question is whether it is a tax. If so, the next question is what kind of tax it is. The answer to that question governs what staleness rule should be applied.

> (ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition.

11 U.S.C. § 507(a)(7)(E).

B. "Excise Tax" in Section 507(a)(7)(E) of the Bankruptcy Code Is a Broad, Residual Category.

"Excise tax" is the most inclusive of the categories of taxes enumerated in section 507(a)(7) and is properly viewed as a residual category. Historically, this Court has construed "excise tax" broadly. *See, e.g., Chas. C. Steward Machine Co. v. Davis*, 301 U.S. 548, 582 (1937); *Bromley v. McCaughn*, 280 U.S. 124, 137 (1929); *Springer v. United States*, 102 U.S. 586 (1881). That broad construction is informative, courts have held, in interpreting "excise tax" in section 507(a)(7)(E) of the Bankruptcy Code. *See Beaman*, 9 B.R. at 541; *United States v. King (In re King)*, 19 B.R. 936, 939 (Bankr. E.D. Tenn. 1982). "Congress' use of the broadly defined category of 'excise taxes' *was designed to include all indirect taxes not otherwise included in [§ 507(a)(7)].*" *Beaman*, 9 B.R. at 541 (emphasis added).[16]

The legislative history of the Bankruptcy Reform Act of 1978 confirms that "excise tax" must be read broadly. The joint floor statements provided:

> *All Federal, State, or local taxes generally considered or expressly treated as excises are covered by this category, including* sales taxes, estate and gift taxes, gasoline

16 *See also New Neighborhoods, Inc. v. West Virginia Workers' Compensation Fund*, 886 F.2d 714, 719 (4th Cir. 1989); *In re TRI-Mfg.*, 82 B.R. at 60; *In re King*, 19 B.R. at 939.

and special fuel taxes, and wagering and
truck taxes.

124 Cong. Rec. 32416 (1978) (Rep. Edwards) (emphasis added); *id.* at 33998, 34016 (Sen. DeConcini) (same).[17] The emphasized language indicates the breadth intended for this priority category. The examples cited, broad in themselves, are not exhaustive, as shown by the word "including." "All" taxes that are "generally considered or expressly treated" as excises come within this category.

C. The Section 4971(a) Exaction Is a "Tax" That Falls Within the Category of "Excise Tax" in Section 507(a)(7)(E).

Resolution of this case is straightforward. As explained above, the first question is whether the ten percent exaction under section 4971(a) is a "tax." On this point, there can be no doubt. Congress has called it a "tax" in the very section of the Internal Revenue Code that imposes it: "For each taxable year . . . there is hereby imposed a tax of 10 percent . . . ." 26 U.S.C. § 4971(a). As the Sixth Circuit pointed out in *United States v. Mansfield Tire & Rubber Co. (In re Mansfield Tire & Rubber Co.)*, 942 F.2d 1055, 1059-60 (6th Cir. 1991), *cert. denied*, 502 U.S. 1092 (1992), tests developed by this Court or other courts to determine whether

[17] Because the House and Senate did not hold a formal conference in enacting the Bankruptcy Reform Act of 1978, floor statements by Representative Edwards and his counterpart floor manager Senator DeConcini have been treated as "persuasive evidence of congressional intent." *Begier v. IRS*, 496 U.S. 53, 64 n.5 (1990).

a particular exaction should be viewed as a tax are not needed when Congress has expressly characterized the exaction as a tax. "We are unaware of any intent by Congress to have its *own* characterizations of payments as 'taxes' subject to second-guessing by the federal courts." *Id.* at 1060 (emphasis in original).

The second question is what category of tax is before the Court -- which staleness rule under section 507(a)(7) should be used? Here again, congressional intent is clear. Congress "expressly treated" the section 4971(a) tax on missed minimum funding contributions as an excise tax. The Conference Report accompanying the 1974 enactment of ERISA explicitly called this tax an "excise tax":

> If the minimum contributions have not been made, the funding standard account will show a deficiency (called an "accumulated funding deficiency"). If there is an accumulated funding deficiency, *an excise tax* is to be imposed on the employer who is responsible for making contributions to the plan. . . .

H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 284 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5065 (emphasis added).

As the Sixth Circuit did in *Mansfield Tire*, the court of appeals here should have given effect to the clear intent of Congress and held that the section 4971(a) exaction is a tax and, in particular, an excise tax.

Instead, the Tenth Circuit applied the four-part test developed in *Lorber*, 675 F.2d at 1066. *United States v. Reorganized CF&I Fabricators, Inc. (In re CF&I Fabricators, Inc.)*, 53 F.3d 1155, 1157-58 (10th Cir. 1995). The court of appeals agreed with the bankruptcy court that the section 4971(a) tax did not meet that test and therefore was not entitled to the priority for excise taxes. *Id.* at 1158 (citing *In re CF&I Fabricators, Inc.*, 148 B.R. 332 (Bankr. D. Utah 1992)).

The court of appeals erred in applying the *Lorber* test to this case. That test was formulated to determine whether a state exaction is a tax for federal bankruptcy purposes. It drew heavily upon this Court's decisions in *New York v. Feiring*, 313 U.S. 283 (1941), and *New Jersey v. Anderson*, 203 U.S. 483 (1906), both of which also involved whether a state exaction was entitled to bankruptcy priority as a tax.

The *Lorber* test, or the *Feiring* and *Anderson* principles from which it was derived, have also been applied to determine whether or not a federal exaction is a tax for bankruptcy purposes in cases where the congressional intent was not explicit. For example, in *United States v. New York*, 315 U.S. 510 (1942), this Court relied on *Feiring* and *Anderson* in holding a claim for taxes on employee income under the Social Security Act to be a priority tax even when assessed against the employer. Similarly, the *Lorber* test and/or the *Feiring/Anderson* criteria have been applied in concluding that "premiums" under the Coal Industry Retiree Health Benefit Act of 1992 were post-petition taxes entitled

to administrative priority[18] and that reclamation "fees" imposed pursuant to the Surface Mining Control and Reclamation Act of 1977 were excise taxes entitled to seventh priority.[19] PBGC has relied on *Feiring* and *Anderson* because its claim for unfunded benefit liabilities, although treated as a tax for enforcement purposes, *see* 29 U.S.C. § 1368, is not labeled a tax in the section imposing the liability, *see* 29 U.S.C. § 1362. In situations like these where the statutory language is ambiguous, analysis of the nature of the exactions is necessary.

In this case, however, the congressional intent to treat the exaction on missed minimum funding contributions as an excise tax is unmistakable. Hence, resort to *Lorber* or any similar test to determine the nature of the exaction is unnecessary and inappropriate.

[18] *LTV Steel Co., Inc. v. Shalala (In re Chateaugay Corp.)*, 53 F.3d 478, 498 (2d Cir.), *cert. denied*, 116 S. Ct. 298 (1995).

[19] *United States v. Ringley*, 985 F.2d 185, 187-88 (4th Cir. 1993); *In re C.M. & C. Coal Co.*, 33 B.R. 358, 359-60 (Bankr. N.D. Ala. 1983); *In re King*, 19 B.R. at 938-39; *see also United States v. River Coal Co.*, 748 F.2d 1103, 1106 (6th Cir. 1984) (pre-petition tax under former Bankruptcy Act).

II. THE SECTION 4971(a) CLAIM MAY NOT BE SUBORDINATED ABSENT INEQUITABLE CONDUCT BY THE CLAIMANT.

The court of appeals not only denied priority to the IRS section 4971(a) excise tax claim, it also subordinated it to the claims of other unsecured creditors under "principles of equitable subordination" pursuant to section 510(c)(1) of the Bankruptcy Code, 11 U.S.C. § 510(c)(1). The court did so even though it found no misconduct by the government.

This holding was wrong, for the reasons stated in the Brief for the United States. The pension insurance system could be jeopardized by a rule that would allow bankruptcy judges virtually unlimited discretion to subordinate claims based on their subjective notions of what is "equitable." As it was in this bankruptcy, PBGC is often one of the largest creditors.[20] Hostility to such a large claimant, particularly a governmental entity like PBGC, is not uncommon. "Equitable subordination," if construed as the lower courts did here, could be used as a weapon against unpopular creditors.[21]

[20] PBGC was either the largest creditor or one of the largest creditors in the bankruptcies of The LTV Corporation, Eastern Air Lines, Pan American World Airways, Wheeling-Pittsburgh Steel Corporation, Sharon Steel Corporation, and New Valley Corporation (formerly Western Union Corporation).

[21] For example, in one pending case, a bankruptcy trustee challenging PBGC's calculation of its claims has argued that the disputed portions -- amounting to millions of dollars -- should be equitably subordinated under 11 U.S.C. § 510(c)(1). *Belfance v. PBGC (In re CSC Industries, Inc.)*, Bankr. No. 93-41898, Adversary Proceeding No. 95-4103 (Bankr. N.D. Ohio).

The use of equitable subordination to deal with entire categories of claims is inappropriate when Congress itself has decided how to allocate limited estate assets among various classes of innocent creditors. As the discussion above illustrates, Congress has taken great care to determine the order in which unsecured claims should be paid. In addition to establishing those payment priorities, Congress has required: that only "substantially similar" claims may be classed together in a plan of reorganization, 11 U.S.C. § 1122(a); that a plan of reorganization must provide "the same treatment" for each claim of a particular class, 11 U.S.C. § 1123(a)(4); and that junior classes may not receive a distribution under a reorganization plan unless senior classes have been paid in full, 11 U.S.C. § 1129(b)(2)(B)(ii). The lower courts' interpretation of equitable subordination would allow for judicial second-guessing of these congressional judgments as well as a reshuffling of the legislated priorities. That cannot be what Congress intended in enacting section 510(c)(1).

This Court should confine the doctrine of equitable subordination to its proper role as a tool to deal with misconduct by a creditor.

III. GRANTING PRIORITY TO THE SECTION 4971(a) CLAIM WILL BENEFIT THE PENSION INSURANCE SYSTEM AND PENSION PLAN PARTICIPANTS.

In denying priority to and subordinating the IRS claims for the section 4971(a) excise tax, the courts below relied in part on the alleged harm contrary rulings would inflict on the pension insurance system and pension plan participants. The courts misperceived the interests of PBGC and participants and were thereby led astray.

In explaining why it was denying priority to the section 4971 claims, the bankruptcy court gave as its first reason the perceived anomaly of putting the IRS tax claim ahead of PBGC's claims:

> This court previously found that the claims of the PBGC for the underlying obligation are, for the most part, pre-petition unsecured claims. To allow priority treatment for alleged tax claims based on pension funding deficiencies, when the pension plan's claims do not receive such treatment, would elevate the section 4971 claims to a status ahead of those claims.

In re CF&I Fabricators, 148 B.R. at 339. The bankruptcy court also asserted that granting priority to the IRS claims "would harm the parties that are intended to be protected by the pension plan that section 4971 seeks to enforce, because payment of section 4971 penalty claims would be at the

expense of pre-petition unsecured creditors including pensioners." *Id.*

The court of appeals applied similar reasoning in its decision to subordinate the IRS claims. After noting that unsecured creditors would receive only a small percentage of their claims, the court stated:

> One of CF&I's unsecured creditors is the PBGC, which will be paying the pension benefits due under CF&I's terminated pension plan. Declining to subordinate the IRS's penalty claim would harm innocent creditors rather than punish the debtor for failing to fund the pension plan.

Reorganized CF&I Fabricators, 53 F.3d at 1159.

These statements assume that PBGC's claims are not entitled to priority. Although the bankruptcy court and the district court have so ruled, no final order has yet been issued and PBGC will vigorously seek reversal in the court of appeals. Portions of PBGC's claims could ultimately receive priority along with the IRS section 4971(a) claims.

More important, the lower courts have lost sight of the forest for the trees. PBGC's financial health will not be greatly affected by the size of its recovery in this case, regardless of the outcome of the litigation over its claims. What would make a major difference to PBGC would be compliance by employers with ERISA's minimum funding

standards. Inducing such compliance, of course, is the purpose behind the section 4971 excise taxes.

Congress has long recognized the effect on PBGC of the minimum funding standards. When ERISA was enacted, one of the principal Senate sponsors explained that the PBGC "termination insurance program is intended to work hand in hand with the minimum funding standards imposed by the bill, since the latter will limit the losses due to plan termination by requiring more adequate funding of pension plans." 120 Cong. Rec. 29952 (1974) (Sen. Nelson). Congress has tightened the funding requirements several times since ERISA was passed, with a view toward strengthening PBGC.[22]

Indeed, in 1987 Congress increased the section 4971(a) tax from five percent to ten percent in order to protect PBGC. At that time, Congress had before it a GAO report entitled *Pension Plans: Government Insurance Program Threatened By Its Growing Deficit*, GAO/HRD-87-42 (March 19, 1987), which stated that claims against PBGC resulted in large part because of the inadequacy of the then-existing funding standards. S. Finance Committee Print 100-63, 100th Cong., 1st Sess. 170 (1987). The Senate Finance Committee explained that, "in light of the GAO

[22] Pension Protection Act, *supra* note 5, §§ 9303-07, 101 Stat. 1330-333 to -359. Only a little over a year ago, Congress again tightened the minimum funding rules in the Retirement Protection Act of 1994, Pub. L. No. 103-465, §§ 751, 761, 108 Stat. 4809, 5012-22, 5024-34 (1994).

report," the increase in the section 4971(a) tax was needed to ensure that contributions are made when due. *Id.* at 180.

The section 4971 excise taxes are thus important to the well-being of the PBGC pension insurance program. Denying them priority or, worse, subordinating them to the claims of other unsecured creditors would greatly diminish their effectiveness. In PBGC's experience, employers whose pension plans are seriously underfunded are most likely to stop making minimum funding contributions just before entering bankruptcy. Often, they also fail to make pension contributions during bankruptcy proceedings. That is precisely what CF&I did in this case, even though it continued to make millions of dollars of payments during the bankruptcy for other employee benefits such as health and life insurance. Granting priority to the IRS excise taxes would provide a powerful incentive to such employers to stop treating their pension plans as an (involuntary) lender of last resort.[23]

The interests of pension plan participants must similarly be viewed from a wider angle than the courts below used. More than 41 million Americans are insured by PBGC in about 58,000 plans subject to ERISA's minimum funding standards. PBGC Annual Report to the Congress, inside cover (1994). The best protection for these workers and retirees also lies in compliance by their employers with those

[23] As it did in this case, PBGC may involuntarily terminate a plan to limit its own mounting losses when contributions are not being made. *See* 29 U.S.C. § 1342(a)(1) and (4). But plan termination often has adverse consequences for participants, the employer, and the agency.

funding standards. Granting priority in bankruptcy for the excise tax on missed contributions will strengthen that protection.

CONCLUSION

The decision of the court of appeals should be reversed. The section 4971(a) tax should be accorded priority as an excise tax under section 507(a)(7)(E) of the Bankruptcy Code. It should not be subordinated to the claims of other creditors.

Respectfully submitted,

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